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To: Supervisor Don Knabe, Chairman
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From: William T Fujioka
Chief Executive Officer

SACRAMENTO UPDATE

State Budget Update – Legislature Adopts Majority-Vote Budget Plan

Today, the Legislature passed an $18 billion majority-vote plan to reduce the State's looming $40 billion budget shortfall through June 30, 2009. The Democrats' Plan (Plan) would increase general fund revenues by $9.3 billion, reduce expenditures by $7.3 billion, employ $1.5 billion in other solutions such as special fund shifts, and enact an Economic Stimulus Plan to create new jobs to help jump start California's stagnant economy. The Plan was approved by both houses. **However, within two hours of the Legislature's adjournment, according to various news accounts, Governor Schwarzenegger announced that he plans to veto the entire $18 billion package.** In addition, Republican members and other groups also indicated their intention to test the legality of these actions in court, if the Plan was enacted.

The key aspect of the Plan is its reliance on a majority-vote rather than on its component parts. Democrats contend that it is possible to raise some taxes and reduce others by the same amount without triggering the two-thirds vote requirement. None of the legislative proposals are available in print.

Revenue Components of the Democrats' Plan

The key elements of the Plan would be implemented in the following manner. Legislation would eliminate the existing 18-cent per gallon tax on motor vehicle fuel, and the accompanying State sales tax which amounts to 8-cents per gallon, a $4.6 billion per year tax reduction. At the same time, the overall State sales tax would be increased by a half-cent, a 2.5 percent surcharge imposed on all personal income taxes, and a 9.9 percent severance tax levied on oil production in the State which was originally proposed in the Governor's November Revision..

Since the proposed legislation would eliminate $4.6 billion in taxes and raise $4.6 billion in taxes, Democrats contend that the Plan is revenue neutral, and therefore is not subject to the two-thirds rule.

In addition, the Plan proposes to replace the 18-cents per gallon fuel tax and the sales tax on motor fuel by substituting a 39-cents per gallon fee which is an overall increase of 13-cents per gallon. The proceeds from the new fee are estimated to increase funding for the State Highway Account by $500 million annually and for local streets and roads by $643 million a year. The fee will be indexed to adjust for inflation, and because it is a user fee, the revenues must be used for transportation. As indicated above, such user fees can be passed with a majority-vote. According to the Floor Analysis, cities and counties will receive approximately $600 million more in funding from the new fee than from the existing excise and sales tax combined. Distribution will be based on existing formulas.

The Plan also would establish a new 3-percent income withholding requirement for independent contractors which is estimated to generate $2 billion in FY 2009-10.

Finally, the Plan would restructure the 2004 Triple Flip that provided guarantees of repayment to purchasers of State bonds to cover its deficit that year. The Triple Flip increased the State sales tax by a quarter cent, reduced local sales taxes by a similar amount and shifted property taxes to local governments to make up for the loss of part of local sales tax revenues. The State General Fund backfilled schools for the loss of property taxes. The Plan terminates the local sales tax reduction, eliminating the shift of property taxes from schools to local governments, ending the general fund commitment to back fill school funding, and saving the State General Fund $1.5 billion. The Plan assumes that the local government portion of the sales tax would increase by a quarter-cent (about $1.15 billion a year) thereby returning the local sales tax rate to its previous level before the beginning of the triple flip.

Expenditure Reductions and Program Changes

The Plan would: 1) reduce Proposition 98 spending; 2) reduce SSI/SSP grants to the 2008 level and suspend the State COLA for FY 2009-10; 3) suspend the CalWORKs COLA for FY 2009-10; 4) adopt the Governor's proposal to eliminate State General Fund support for various local law enforcement programs which would reduce funding for juvenile probation camps, the Juvenile Justice Crime Prevention Act and the Citizen's Option of Public Safety Programs; and 5) other public safety grant reductions.

The Plan also would allow offenders without current or previous convictions for serious, violent, or sexual crimes to be discharged from parole after six months if they are violation free. Other legislation would authorize the California Department of Corrections and Rehabilitation to provide up to four months of earned credit for successful program completion by eligible inmates, authorize consistent day-for-day credit for all eligible inmates in State prison and those who are in jail pending transfer to State prison, and provide credits to inmates who are awaiting assignment to a conservation camp. Finally, the statutory threshold values for property crimes would be adjusted to reflect inflation since 1982.

Economic Stimulus Package

The Plan also includes an Economic Stimulus package which would: 1) appropriate approximately $2.9 billion in additional infrastructure bond funds to accelerate the construction of projects in 2009, including the improvement of streets and roads, public transit, parks, levees, and water quality projects; 2) exempt hospital nonstructural and alteration projects with an estimated construction cost of less than $500,000 from the Office of Statewide Health Planning and Development's plan review process, and also exempt similar projects with estimated costs of at least $500,000 and less than $1 million if the designs are peer reviewed by independent plan reviewers; 3) expand the number of transportation projects that Caltrans can develop as public-private partnerships (PPP) from four to ten projects, and stipulate that the projects can utilize the design-build contract award method; and 4) provide local governments with the authority to impose an additional 0.25 percent sales and use tax under the Bradley-Burns law to be deposited into a local transportation fund. This tax increase would require a two-thirds approval of the local electorate pursuant to Proposition 218.

We will continue to keep you advised.

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MR:er

c: All Department Heads
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